Department of Commerce
Innovation is in our nature.

# LESSONS LEARNED FROM NSP:

# A GUIDE FOR HOUSING PLANS

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In 2009, the State of Washington's Department of Commerce created the Neighborhood Stabilization Program (NSP).

NSP provides emergency financial assistance to 25 local governments that were hardest hit by the foreclosure crisis. They use NSP funds to redevelop foreclosed properties that drive down neighboring home values.

NSP will end soon -- but the housing crisis continues to persist. Now is a good time to ask -- What lessons can we learn from NSP? What can communities do to recover more quickly from the housing crisis?

This report presents the lessons learned from NSP. It lays the groundwork to update the "Housing Your Community" -- a guidebook developed in 1993 as statewide guidance for drafting the housing elements of city and county comprehensive plans.

The NSP "Closeout Report" / Guidebook will reflect the current challenges jurisdictions face as they update their comprehensive plans. It presents ways for them to recover more quickly.

The first chapter of the report/guidebook describes the foreclosure crisis that caused, in large part, the housing crisis. It presents Washington response to it, which includes NSP. It provides a snapshot of today's housing crisis.

# CHAPTER 1: THE FORECLOSURE CRISIS IN WASHINGTON

## Chapter 1: Foreclosure Crisis



**HOUSING MARKETS IN TRANSITION**

Chairman Bernanke's speech to the National Homebuilders Association is available online.

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## National Housing Crisis

The "Great Recession" began, in large part, by a rapid increase in home foreclosures. Housing prices began to decline in 2006. At the same time, residential foreclosures increased in the subprime market. It quickly spread to the rest of the housing market.

As the economy fell deeper into recession, job losses exacerbated the problem as homeowners struggle to make their mortgage payments.

The size of the problem staggers the imagination. In 2007, the Mortgage Bankers Association (MBA) reported 5.6 million outstanding subprime mortgage loans. Subprime loans represent 13percent of the total number of outstanding homes loans; and they represent 55percent of all the defaulted loans that started the foreclosures process in 2007.[i]

In 2006, the Center for Responsible Lending issued a report predicting 1.1 million households holding subprime mortgages originated in 2005 through 2006 would lose their homes. In 2008, they updated their prediction to 2.2 million homes. In 2009 the U.S. Department of Housing and Urban Development (HUD) released foreclosure data (see Figure 1-2) indicating 5.3 million homes as starting foreclosure or seriously delinquent.[ii]

The ripple effects of foreclosures go beyond just the affected homeowners. Foreclosures diminish the value of nearby properties. It depresses the tax base of the community. Speaking to the National Association of Homebuilders in 2012, Federal Reserve Chairman Ben Bernanke describes the affect as follows:

> *"Foreclosures, particularly when they are geographically concentrated, can diminish the values of nearby properties. .....A vicious circle can get started: Increasing vacancies together with decreasing tax revenue and consequent cutbacks in services can further depress home prices, putting the goal of neighborhood stabilization even further out of reach."*[iii]

### WHAT'S A SUBPRIME LOAN?

Subprime lending refers to loans or mortgages with higher interest rates and less favorable terms than traditional loans.

Many subprime loans have adjustable interest rates. Borrowers get low interest rates for the first year and higher rates in future years.

From the mid-1990s to 2007, home values rose at incredible rates.

Borrowers planned to use the rising value of their homes to convert their subprime loans into traditional loans with fixed interest rates.

But when the housing bubble popped, so did their chances to refinance.

The value of their homes deflated while their interest continued to increase. It left borrowers with increasingly higher loan payments.

Many borrowers were unable to make these higher loan payments and, as result, went into foreclosure.

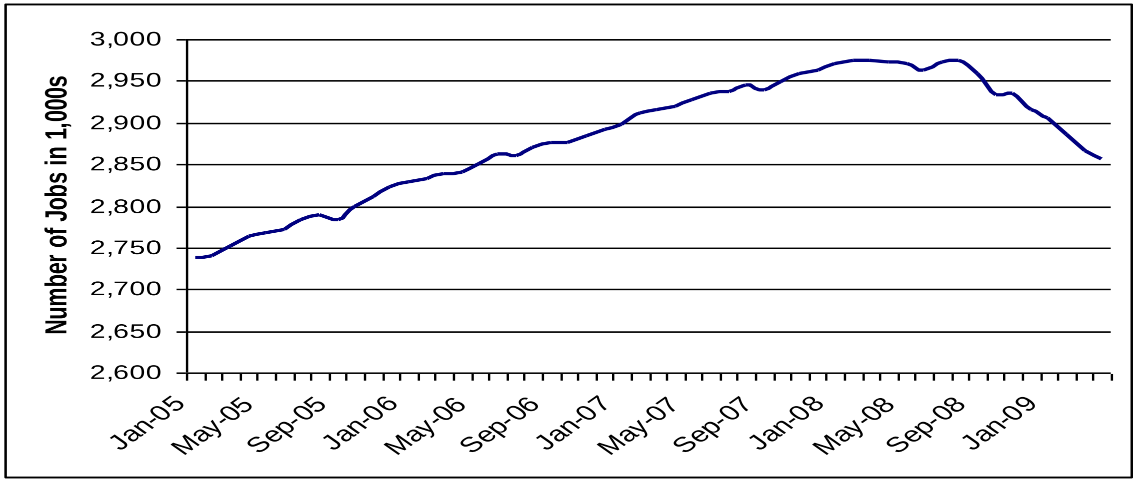
## Housing Crisis Hits Washington

Washington's strong job growth enabled it to weather the storm at the beginning of the foreclosure crisis. At first, the housing crisis in Washington looked less severe than in other states. The outlook changed during the latter half of 2008 and the first half of 2009.

The housing crisis accelerated as Washington lost jobs. Figure 1-1 shows the change in Washington's job growth from 2005 to 2009. Job growth reached its peak in 2008. By the end of 2009, Washington lost all the jobs it gained since May 2006. It lost nearly 140,000 jobs. Nearly one-third of the jobs lost were from the construction industry.

**FIGURE 1-1**

**Total Jobs in Washington 2005 – 2009[iv]**




Washington's large number of subprime loans and mortgages added fuel to its growing housing crisis. Washington ranks among the top third of the states with the largest number of subprime loans. Adding this large number of subprime loans to job loss causes foreclosure rates to increase.

Washington's foreclosure rate increased from 1.5percent in 2008 to 5.5percent in 2009. It more than doubled over the course of one year. In 2009 HUD estimated that Washington had over 60,000 mortgages either in foreclosure or seriously delinquent.

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## FIGURE 1-2

## HUD Foreclosure Data for Washington

## October 28, 2008

**Table 1: Foreclosure Needs Scores within States by CDBG Jurisdiction -- October 28, 2008**

*Source: Analysis by the Local Initiative Support Corporation provided by the Foreclosure Response project*

For definitions and detailed documentation, see http://www.housingpolicy.org/assets/foreclosure-response/methodology.pdf

To view data for one state at a time, click on the arrow and pick your state from the dropdown menu.

| State | CDBG Name | Intrastate Foreclosure Needs Score | Estimated Total Number of Loans | Estimated Number of Subprime Loans | Pct. of All Loans: Subprime | Estimated Number of Loans Delinquent 30+ Days | Pct. of All Loans: 30+ Days Delinquent | Estimated Number of Foreclosed Loans | Pct. of All Loans: In Foreclosure |
|---|---|---|---|---|---|---|---|---|---|
| WASHINGTON | | | | | | | | | |
| | Pierce County | 100.0 | 109,090 | 14,639 | 13.42 | 6,302 | 5.78 | 2,392 | 2.19 |
| | Tacoma | 65.7 | 41,916 | 6,972 | 16.63 | 2,586 | 6.17 | 1,127 | 2.69 |
| | Snohomish County | 49.3 | 128,748 | 11,256 | 8.74 | 4,876 | 3.79 | 1,734 | 1.35 |
| | King County | 48.7 | 197,154 | 13,354 | 6.77 | 5,479 | 2.78 | 2,073 | 1.05 |
| | Clark County | 33.6 | 63,491 | 6,012 | 9.47 | 2,793 | 4.40 | 1,237 | 1.95 |
| | Spokane | 23.1 | 48,962 | 4,581 | 9.36 | 2,148 | 4.39 | 745 | 1.52 |
| | Vancouver | 17.1 | 28,973 | 3,095 | 10.68 | 1,265 | 4.36 | 571 | 1.97 |
| | Spokane County | 14.7 | 45,468 | 3,350 | 7.37 | 1,767 | 3.89 | 553 | 1.22 |
| | Kitsap County | 14.3 | 42,931 | 3,501 | 8.15 | 1,534 | 3.57 | 527 | 1.23 |
| | Federal Way | 13.9 | 16,452 | 2,199 | 13.36 | 819 | 4.98 | 371 | 2.25 |
| | Yakima | 13.9 | 15,835 | 1,939 | 12.24 | 905 | 5.72 | 387 | 2.44 |
| | Lakewood | 13.4 | 10,015 | 1,492 | 14.90 | 594 | 5.93 | 253 | 2.53 |
| | Everett | 11.7 | 23,810 | 2,436 | 10.23 | 996 | 4.18 | 340 | 1.43 |
| | Kent City | 10.1 | 14,558 | 1,671 | 11.48 | 720 | 4.94 | 300 | 2.06 |
| | Seattle | 9.8 | 121,215 | 4,965 | 4.10 | 2,028 | 1.67 | 756 | 0.62 |
| | Pasco | 8.6 | 9,873 | 1,311 | 13.28 | 587 | 5.95 | 175 | 1.77 |
| | Auburn | 7.5 | 11,142 | 1,327 | 11.91 | 506 | 4.54 | 218 | 1.95 |
| | Kennewick | 6.4 | 13,211 | 1,239 | 9.38 | 591 | 4.47 | 204 | 1.54 |
| | Bremerton | 6.2 | 11,168 | 1,150 | 10.29 | 508 | 4.55 | 191 | 1.71 |
| | Longview | 3.7 | 8,276 | 753 | 9.10 | 377 | 4.56 | 97 | 1.18 |
| | Renton City | 3.0 | 8,916 | 723 | 8.11 | 288 | 3.23 | 137 | 1.54 |
| | Olympia | 2.8 | 15,520 | 998 | 6.43 | 377 | 2.43 | 134 | 0.86 |
| | Richland | 2.6 | 9,406 | 678 | 7.21 | 317 | 3.37 | 103 | 1.10 |
| | Bellingham | 2.5 | 18,270 | 968 | 5.30 | 405 | 2.22 | 144 | 0.79 |
| | Mount Vernon | 2.1 | 5,600 | 492 | 8.79 | 209 | 3.73 | 71 | 1.26 |
| | Bellevue | 1.6 | 29,983 | 1,087 | 3.62 | 382 | 1.27 | 140 | 0.47 |
| | Wenatchee | 1.6 | 6,172 | 532 | 8.62 | 151 | 2.44 | 47 | 0.76 |
| | Shoreline | 0.9 | 9,883 | 467 | 4.73 | 157 | 1.59 | 70 | 0.71 |
| | Anacortes | 0.4 | 4,787 | 197 | 4.12 | 89 | 1.86 | 13 | 0.26 |
| | Washington Outside CDBG Areas | | 300,499 | 29,127 | 9.69 | 12,540 | 4.17 | 4,333 | 1.44 |
| | State Total | | 1,371,326 | 122,511 | 8.93 | 52,295 | 3.81 | 19,442 | 1.42 |

**FORECLOSURE FAIRNESS PROGRAM**

The Foreclosure Fairness Program was created by the Foreclosure Fairness Act, passed during the 2011 legislative session.

State law now requires lenders to notify borrowers prior to foreclosure of the availability of foreclosure counseling and the potential for mediation.

Commerce's Foreclosure Fairness Program provides homeowner foreclosure assistance.

FREE housing counseling is available to help homeowners understand their options and determine the best course of action.

For more information,

Call – 360-725-3026

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## Washington's Initial Response

In July 2008, Congress enacted the Housing and Economic Recovery Act of 2008 (HERA). HERA was designed primarily to address the subprime mortgage crisis. A few months later Congress enacted the American Recovery and Reinvestment Act of 2009 (ARRA). ARRA was a more comprehensive response to the recession growing out of the housing crisis.

Governor Gregoire directed all state agencies to prepare plans for the implementation of HERA and ARRA. Commerce's implementation plan included a housing strategy. Its housing strategy had three objectives.

- Recovery**:** Involves getting money into local communities to recover foreclosed homes and prevent homelessness. Commerce's Recovery Strategy consisted of two main programs: its $28 million Neighborhood Stabilization Program and its $11 million Homeless Prevention and Rapid Re-Housing Program. These programs provided nearly $40 million of emergency assistance.

- Prevention & Protection: Strives to reverse the increasing foreclosure rate. Commerce wanted to assist troubled homeowners who are facing foreclosure. The 2011 Legislative Session created the Foreclosure Fairness Program.

- Restoration and Viability**:** Urges local communities to develop their own housing stimulus plans, along with the development regulations to implement them. Commerce encourages local governments to focus on enacting affordable housing incentives currently allowed in the GMA along with an increased emphasis toward in-fill and transit-oriented developments or comparable housing strategies that take advantage of existing infrastructure improvements.

NSP
WASHINGTON
Neighborhood Stabilization Program

### WHAT IS NSP?

NSP provides emergency assistance to states and local governments.

They use NSP funds to acquire and redevelop foreclosed properties that drive down surrounding neighboring property values.

HUD administers the program through its Community Development Block Grant (CDBG) program. With a few exceptions, NSP must follow CDBG rules and regulations.

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## Neighborhood Stabilization Program

Congress enacted the Housing and Economic Recovery Act (HERA) in July 2008. The intent of HERA was to stop the precipitous decline of neighborhood property values. It included the Neighborhood Stabilization Program (NSP).

This first round of NSP funds ($3.92 billion) was distributed to 306 states, cities, and counties via a needs-based formula allocation.

During the first round of NSP funding, HERA established a 'formula allocation grant program' to distribute NSP funds to states and localities. The formula was outlined in the legislation. It was based on the number and percentage of home foreclosures, the number and percentage of homes financed by a subprime mortgages, and the number and percentage of homes in default or delinquency in those areas.

HERA raised the income threshold. It states NSP funds must house individuals and families whose incomes do not exceed 120percent of area median income (AMI). However, not less than 25percent of funds may be used to house individuals or families whose incomes do not exceed 50percent of AMI.

All homes acquired for NSP must be purchased at a discount from the appraised price. Program income must be used for other NSP-eligible activities.

Congress enacted two additional rounds of NSP funding (NSP2 and NSP3). On February 17, 2009, the American Recovery and Reinvestment Act (ARRA) provided an additional $2 billion for the program via a competitive allocation. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act provided an additional $1 billion for a third round. The third round (NSP 3) combined the needs-based formula of the first round to site-specific targets developed in the second round.

HERA's NSP-1:

On October 6, 2008, HUD released the regulations for NSP. They announced which jurisdictions would receive an allocation. All 50 states as well as 256 cities and counties (plus three territories) received a direct NSP allocation. The minimum allocation for states was $19.6 million, and the minimum allocation for cities and counties was $2 million.

Communities eligible to receive NSP funds submitted action plans to HUD, and most signed grant agreements in March of 2009. The statute required that all funds be obligated within 18 months of receipt--September 2010 for most grantees.

**FIGURE 3**

**NSP Eligible Uses**

| | |
|---|---|
| Type A | Establish financing mechanisms for purchase and redevelopment of foreclosed homes or residential properties, including such mechanisms as soft-seconds, loan loss reserves and shared-equity loans for low- and moderate-income buyers |
| Type B | Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed and make them available to be sold, rented or redeveloped |
| Type C | Establish and operate land banks for foreclosed single- and multifamily properties. |
| Type D | Demolish blighted structures. |
| Type E | Redevelop demolished or vacant properties as housing (under Use E, NSP1 funds may be used for nonresidential purposes; NSP2 and NSP3 funds must be used for housing). |

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**Spinoffs from Washington's NSP2 Application**

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ARRA's Competitive Program – NSP2

NSP2 was created in the American Recovery and Reinvestment Act and provided additional funds to be distributed by a competition to state and local governments. Unlike the first round of NSP, nonprofit entities, and consortiums of state governments, local governments, for-profits, and/or nonprofits were all eligible applicants.

On May 4, 2009, HUD released the Notice of Funding Availability (NOFA) for NSP2. Applications were due on July 17, 2009. In January, HUD announced that 56 grantees received NSP-2 funds. The vast majority of these were local consortiums that consisted of local governments and/or nonprofits.

Although Washington submitted an NSP-2 grant application, it did not receive a grant. HUD received 482 applications seeking $15 billion of funds. It awarded 56 grants to agencies providing services to locations in 29 states. Only one out of eight applicants for NSP2 funds received a grant award.

The majority of the NSP2 funds went to states that have substantially higher rates of foreclosure than found in Washington. Two-thirds of the total NSP2 grant funds when to agencies that serve five states -- Florida ($348 million), California ($318 million), Michigan ($223 million), Ohio ($175 million), and Illinois ($160 million). These five states are within the top ten states hardest hit by the foreclosure crisis.

Among the remaining 24 states, HUD apparently tried to distribute the funds as broadly as possible. Agencies requesting smaller grant amounts with site-specific projects had a distinct advantage. The amount of grant funds requested in the Department of Commerce's grant application ($57 million) was several times more than the average grant request. The median grant request among all the grant applicants was $12 million.

Bridge Notice and other NSP changes.

Despite being such a new program, HUD made a number of important legislative and regulatory changes to NSP shortly after the program began.

On June 15, 2009, HUD released the NSP1 Federal Bridge Notice, which detailed how changes in ARRA would apply retroactively to NSP1.

Among other changes, the Bridge Notice reduced the minimum purchase discount requirement from five to one percent for each property.  It waived appraisals for properties valued at $25,000 or less.

Recapture and Reallocation

NSP1 grantees were required to obligate all of their funds within 18 months and un-obligated funds would be subject to recapture.

On August 23, 2010, HUD released the Notice of NSP Reallocation Process Changes, which described the corrective actions and recapture process affecting grantees that failed to meet the 18-month deadline for obligating NSP1 funds.

The Notice permitted most cities and counties to retain their un-obligated funds if they entered into a memorandum of agreement with HUD to improve performance.

However, very little money was recaptured because as of October 19, 2010, 99.7percent of all NSP1 funds had been obligated.

Washington obligated 99.9 percent of its NSP funds.

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Dodd-Frank Formula Grant Program – NSP3

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. It included $1 billion for a third round of NSP (NSP3).

On September 8, 2010, HUD released the formula allocations for 280 grantees. All 50 states and the District of Columbia received a minimum of $5 million, and the minimum grant size for cities and counties was $1 million. Washington received a $5 million allocation of NSP-3 funds.

In February 2011, Commerce solicited a Request for Proposals (RFP) among its existing NSP jurisdictions. The RFP sought high-impact, site-specific projects located in areas designated by HUD as having the greatest need for assistance s in our state.

Commerce had received 12 proposals requesting a total of $12,720,500 in NSP3 funding. They evaluated proposals by giving preference to projects that:

- Demonstrate readiness to proceed.
- Leverage other funds by demonstrating partnerships and local commitment.
- Generate or recovered the most housing units, particularly rental housing.
- Encourage vicinity hiring.

Commerce awarded all its available NSP-3 funds to four jurisdictions:

- Federal Way: $1.7 million for the Westway Neighborhood Housing Project.
- Lakewood: $640,000 for the Tillicum Low-Income Housing Project.
- Snohomish County: $1.1 million for the Park Place Townhome Rentals Project.
- Spokane: $1.4 million for the East Sprague Avenue Rentals Project.

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## Washington's Foreclosure Crisis Today

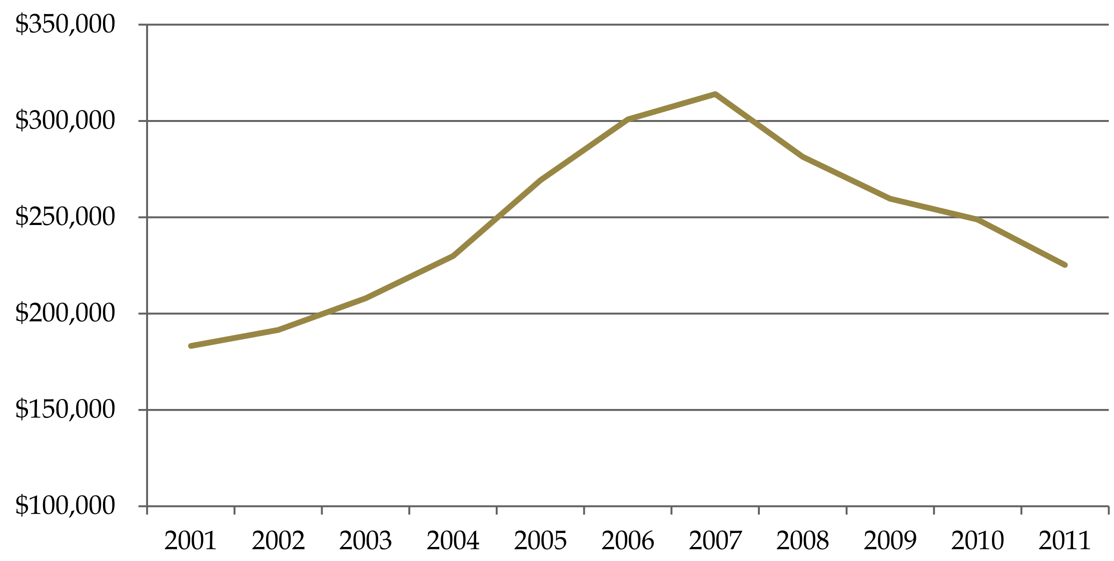
Washington still has not regained all the jobs it lost since 2008. Construction jobs dropped from seven percent of total jobs in Year 2000 to five percent in Year 2011.

From the 2000 to 2010 Census, Washington lost nearly 60,000 construction jobs, which results in a loss of over $3 billion in the State's income base. The increased number of jobs in the service and hospitality industries absorbs only a portion of this lost income.[v]

The downturn in the sale of new and previously owned homes is a major contributor to the current recession. Median housing prices dropped 32 percent since reaching their high of $314,000 in Year 2007. The median housing price in 2011 is approximately $225,330, a loss of $88,700 in home value.[vi]

**FIGURE 5**

**Median Price of Single-Family Homes**
End of Third Quarter for Years 2001 to 2011

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A number of factors contribute to the current decline in home values. Chief among them is Washington's increasing rate of foreclosures.

According to the Mortgage Bankers Association, Washington's foreclosure rate has increased from approximately two percent in Year 2008 to 6.4 percent in Year 2011. They estimate approximately 76,400 Washington mortgages are seriously delinquent[vii].

The auction and short-sale of foreclosed or at-risk homes depresses the housing market. Short-sales occur when lenders allow the sale of homes for less than the amount due on the mortgage. The lower prices of foreclosed homes cause all home prices to fall.

Chairman Bernanke explains the impact in his 2012 speech to the National Homebuilder's Association:

> *"Declines in house prices have reduced homeowners' equity by more than 50 percent in the aggregate since the peak of the housing boom, resulting in more than a $7 trillion loss of household wealth. Indeed, about 12 million homeowners – more than 1 out of 5 with a mortgage – are underwater, meaning they owe more on their mortgages than their homes are worth. One of the effects of declines in housing wealth is to reduce the ability and willingness of households to spend. While estimates vary, homeowners are believed to spend somewhere between $3 and $5 per year less for every $100 of housing value lost. Based on those estimates, it appears that recent declines in housing wealth may be reducing consumer spending between $200 billion and declines in housing wealth may be reducing consumer spending between $200 billion and $375 billion per year. That reduction corresponds to lower living standards for many Americans."*

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## ENDNOTES

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[i] Mortgage Bankers Association, "Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey, December 6, 2007.

[ii] Center for Responsible Lending, "Third Report on Spillover Impact of Mortgage Foreclosures", May 2009.

[iii] Speech by Mr. Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, at the 2012 National Association of Homebuilders International Builders' Show, Orlando, Florida, February 10, 2012.

[iv] Source: State of Washington Department of Employment Security

[v] Department of Employment Security, Nonagricultural Wage and Salary Employment: 2011, U.S. Census Bureau, Year 2000 Census, Table P-49: Sex by Industry for the Employed Civilian Population 16 Years and Over.

[vi] Washington Center for Real Estate Research, "Washington State's Housing Market: 3rd Quarter 2001", December 2011, page 12

[vii] Washington Center Real Estate Research, "Washington State's Housing Market: 2nd Quarter 2011," September 2011, page 7.

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